LIMITATIONS UPON NATIONAL REGULATION OF RAILROADS

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This paper is written from the point of view of those who are engaged in the management of the railroad business. For convenience of treatment, the subject is divided into three parts: 1. The Extent of the Federal Power over Railroads. 2. Limitations by Economic Laws. 3. Limitations by Common Law.

I. *The Extent of the Federal Power over Railroads.*

The federal power over railroads is confined to their operations in respect to commerce with foreign nations, among the several states and with the Indian tribes. The courts have held that when an article of commerce begins to move from a point in one state to an ultimate destination in another state, or even to a destination in the same state, if it is to pass into another state in transit, interstate commerce with respect to that article begins. But there is still a very considerable movement of freight and passengers upon the railroads of this country which is confined within the limits of a single state and is entirely beyond the power of Congress to regulate.

Most of the equipment of nearly every railroad, however, is used from time to time in the movement of interstate commerce, and national regulations respecting safety appliances therefore include practically all the railroad equipment in the country.

Over that portion of the business of the railroads included in the term "interstate commerce," the power of Congress is absolutely exclusive whether actually exercised or not. Even in the absence of any enactment by the federal government the states are powerless to

enact laws which would amount to a regulation of interstate commerce.

The Supreme Court of the United States has said that the non-exercise by Congress of this power in respect to the regulation of commerce among the states is equivalent to a declaration that such commerce shall be free from any restrictions or impositions. The power to regulate has been held also to include power to prohibit commerce among the several states in cases where commerce affects injuriously the public welfare, as in the case of the sale of lottery tickets.

Aside from provisions for the general welfare of the public and the employees of the railroad companies found in the requirements respecting the instrumentalities of commerce, the federal regulation is most influential upon the rates which may be charged for the transportation service. Congress, undoubtedly, has power to prescribe reasonable rates for such transportation, either maximum, minimum or absolute. The magnitude of the problem as it is presented in this country and the manifest difficulty of dealing with it in a deliberative body so large as the Congress have naturally suggested the assignment of the labor to a commission; but the provision of the Constitution is that *Congress* shall have power to regulate. The fixing of rates is a legislative function and it is a well settled rule of law that Congress may not delegate its legislative functions to any subordinate board or body. The question arises whether Congress may delegate to a commission the power to prescribe transportation rates,—whether an act purporting to confer such power upon a commission would not be void as being an attempted delegation of a legislative function entrusted by the Constitution to the Congress.

The authorities agree that Congress may prescribe certain rules which shall be applicable to certain conditions and entrust to some executive officer or administrative board the determination of the question whether those conditions are present in a given case. Congress, for example, may authorize the President to suspend, by proclamation, the free introduction of certain commodities from a country which does not afford reciprocal treatment to our products, leaving to him the determination of the question of fact, whether the treatment accorded by such country is in fact reciprocal. Such an act was held not to be a delegation of legislative power and there-

fore not unconstitutional. (Field *vs.* Clark, 143 U. S., 649.) Or, Congress may leave to a board of inspectors the determination of the question whether teas presented for import are of inferior grade within the meaning of the act. (Buttfield *vs.* Stranahan, 192 U. S., 470.) But, if the act purports to transfer to a subordinate board or body any function which is properly legislative in its nature, whether its exercise be limited or unlimited, it should be held to be void.

It would not be permissible for Congress to confer upon a commission the power to fix transportation rates for the future, subject only to the limitation that such rates should be "reasonable." Such an act should be held void as a delegation of legislative power. It would be permissible for Congress to pass an act declaring that transportation rates should be reasonable, and conferring upon a commission, subject to a judicial review, the power to determine a maximum rate, any increase of which would be extortion, and a minimum rate, any decrease of which would be considered confiscation. But between these two extremes, Congress alone has the power to exercise the federal authority to prescribe.

The term "reasonable" as used in the law on the subject of rates for *quasi* public service is intended to define rates which are not so high, when considered from the point of view of the public with reference to the value of the service rendered, as to amount to extortion, and on the other hand are not so low, when considered from the point of view of the carrier with reference to the return upon the investment, as to amount to a taking of property without due process of law or confiscation. Between these two extremes, there may be, and usually is, a considerable latitude within which rates may be raised or lowered and still be reasonable. If Congress declares that the rates shall be reasonable, it simply declares that they shall not be so high as to amount to extortion, nor so low as to amount to confiscation, and it would be competent to commit to a commission the power to determine, subject to judicial review, the question whether a given schedule is outside the limit or not, in other words to fix the maximum and the minimum. But it would not be competent for Congress to give to any commission absolute discretion to fix the rates for the future within these limits of reasonableness, for that would be a delegation of legislative power and absolutely beyond the jurisdiction of the courts to review. The judicial power to review legislation on this subject extends only to relieving

the carrier from rates which amount to confiscation, or the shipper from rates which amount to extortion; but in the review of the action of a commission fixing maximum and minimum rates the judicial arm of the government would guarantee to the carrier a rate which would be measured by the fair value of the service rendered and any maximum rate thus fixed below that point would be set aside. If the lowest rate for a given transportation service which would allow the carrier a fair return upon his investment is eighty cents and the highest which would not amount to extortion is one hundred cents, the Congress might prescribe a rate of ninety cents, but a commission exercising a power to fix maximum or minimum rates could not lawfully adopt ninety as the minimum and ninety as the maximum. The courts would review such a proceeding and upon a proper showing would set it aside.

We are not unmindful of a number of decisions of the Supreme Court of the United States, which are cited as giving support to a different view, but we do not so understand them.[1]

II. *Limitations Imposed by Economic Laws.*

There are certain limitations upon the exercise of the power of the government to regulate railroad rates which must be observed in the formulation of any statute designed to regulate rates. It is a common opinion among those who listen with approval to declamations in favor of government regulation of railroad rates that at the present time the rates for the transportation of freight by railroads in this country are prescribed by the traffic managers at will and that there is nothing to prevent their increase to almost any extent. This opinion is erroneous. Traffic managers of the railroads of this country do not make rates at will. There are at least two classes of limitations by which they are at all times controlled: (*a*) Limitations by economic laws; (*b*) Limitations by common law.

The first class of limitations upon the power of the traffic managers of the railroads of this country over rates is imposed by economic law. Any attempt at regulation of railroad rates by Congress which does not observe these limitations will be certain to fail to

[1] Stone *vs.* Farmers' Loan and Trust Co., 116 U. S. 307; Reagan *vs.* Farmers' Loan and Trust Co., 154 U. S. 362; Interstate Commerce Commission *vs.* C. N. O. & T. P. Ry. Co., 167 U. S. 479.

satisfy the country as a whole, and if enforced and persisted in will do more harm than good to the commercial interests of the nation. The law to which we refer is the law of competition in trade.

In the first place, we must not lose sight of the very great variety of articles of commerce which are offered to the railroads for transportation. Some combine great value with very small weight or volume, while others combine great weight or volume with little value. Some are perishable. Some are frail. Some are alive. Some are dead. Some require two or three cars coupled together to support them, while others need no car at all but move upon wheels of their own. Some go on flat cars exposed to the storm; others will spoil if they are not kept dry. Some are so combustible that they cannot be placed near the engine. Some are explosive and will be discharged by rough handling of the car. Some must have water in transit and some must have ice, and some must be accompanied by an attendant.

These considerations and others, which might be mentioned, necessitate classification of freight; and classifications have been made in which some ten thousand different commodities which are from time to time offered to railroads for transportation, are named and classified; and such classifications are in force all over the country.

But classification of freight overcomes only a few of the difficulties which confront the rate-makers. Railroad business differs from almost every other kind of business in that it is not the carrier that can render the service with the least expense to itself that offers the lowest rate. If a railroad has been built between two points which furnish business sufficient to enable it, with reasonable rates, to pay operating expenses and a dividend, it is considered that any additional business which it may be able to secure, even though it may divert it from some other carrier having a direct route, is almost clear profit. It therefore happens that nearly every railroad company, in addition to what may be called its legitimate business, attempts to secure, by joint arrangement with its connections, traffic between points which are reached by it with its connections, not in a direct line but in a roundabout route, and in order to secure such traffic it offers rates much below what would be considered "reasonable" for the business which naturally belongs to it and which it is best qualified by reason of location to handle, and offers rates also

much below what the owners of a more direct route will demand for carrying the business. It often happens therefore that a railroad company having the shorter line between two important points may be compelled to meet the competition of a number of connecting lines constituting a route which is much longer and far away from the direct line.

The Michigan Central has a joint rate in force from Detroit to East St. Louis, and also to East Fort Madison, both being Mississippi River crossings. The rate to East Fort Madison is higher than the rate to East St. Louis, and that higher rate is applied to traffic destined to East Fort Madison. If, however, the traffic is destined to Omaha, the lines by way of East St. Louis will compete for the business and the carriers reaching East Fort Madison therefore publish another lower rate to that point for traffic destined beyond, which does not exceed the rate to East St. Louis. This lower rate is called a proportional rate.

Then there may be situated on the line of a railroad an industry making use of large quantities of raw material, all coming from some particular mine or quarry from which this particular industry takes the entire output. Here will be an extensive traffic in one particular commodity between the mine or quarry and this one industry, with which no other traffic comes into competition, and the carriers have found it advisable to publish a special rate for such business, known as a commodity rate. A number of articles, such as grain, coal, live stock and dressed meats, which move in very large quantities in one direction are handled upon a commodity rate.

It sometimes happens that a territory served by a carrier may have a product, peculiar to that territory, which seeks a market far away, and instead of making rates on that product varying with each station in the territory, it has been deemed fair to establish a rate which shall apply to all the stations in the territory, so that all within that district may sell their product at the same price and receive the same net proceeds after payment of the freight. Such rates are called group rates and they are quite common in some parts of the country.

The cost of water transportation from Chicago to New York is made the basis for the determination of the rates between the Atlantic seaboard points and a very large portion of the country; the rates to other points, by concerted action on the part of the

principal carriers, being made a certain percentage of the Chicago rate. Thus the rate from New York to Cincinnati is 87 per cent. of the Chicago rate; to St. Louis, 116 per cent.; to Louisville, 100 per cent.; to Cleveland, 71 per cent.; etc. In some sections of the country the areas of these groups are defined, bounded and published upon a map which is placed in the hands of the traffic managers of the interested roads. The groups vary in size and their area is regulated by commercial conditions.

These various classes of rates, as well as the classification of freight, are made necessary by commercial considerations, and result from the laws of trade which must be given effect and recognition in any attempt at national regulation.

The plan of grouping has been objected to as denying to the producers in some parts of the territory included in the group, the advantage to which their location, that is, their proximity to the market, is supposed to entitle them; and it is likely that if the government should attempt to prescribe rates, there would be an effort made to have the group system abandoned. But it has been demonstrated in the experience of Germany that it is for the best interest of the nation to put the entire territory upon an equal footing as far as possible, rather than to allow to each farmer some advantage in freight rates over his next neighbor who may live a short distance farther away from the market, because of his geographical location. In other words, rates must be such as to stimulate production and at the same time move the product. In Germany, where they have had government ownership of railroads since 1879, the government prescribed a rate on grain of a certain sum per ton per mile, regardless of the distance moved and regardless of all other conditions affecting the grain trade. The result was that grain could not move by rail from eastern Germany, where it was raised in large quantities, to western Germany, where the demand was greatest, but was compelled to seek an outlet by a devious water route with a short rail haul at both ends of the line. In 1888 the farmers of eastern Germany demanded a reduction of the grain rate so as to permit them to move it by rail, but the demand was refused on the ground that a reduction would have a tendency to raise the value of farm land in eastern Germany and deny to the farmers in western Germany the advantage to which they were entitled by their geographical location. In 1891 there were serious

crop failures which brought great hardship upon the laborers in western Germany, and the government was constrained to reduce the rate on grain for distances over one hundred and twenty-five miles, and a sliding scale was put in force which afforded some relief and permitted the grain from eastern Germany to move into the western portion of the empire by rail; but the rate was still much too high and much more than the traffic would bear. The farmers of southern and western Germany protested that they were being deprived of their geographical advantage and when, in 1894, the government desired to make a commercial treaty with Russia, the southern provinces, whose representatives held the balance of power, refused to assent to it unless the rates on grain were changed. The Russian treaty was very important and so an order was issued restoring the uniform rate on grain of a certain sum per ton per mile, regardless of the length of the haul. The result was that the treaty with Russia was promptly authorized.

At the same time, there was a tariff on grain of $8.75 per ton and all grain imported into the German Empire was required to pay $8.75 to the government, so the government allowed to the farmers of eastern Germany a bounty of $8.75 per ton on all grain exported, to enable them to realize the same price for their grain that the farmers in western and southwestern Germany received, the latter price being regulated by the cost of imported grain at the border, plus the tariff.

This illustrates the result in Germany of a government regulation of rates which does not recognize the necessity of limiting the rate to what the traffic will bear, but rests upon the principle that each community is entitled to the advantage resulting from its geographical location.[2]

If the strict rule of making the rate per ton per mile the same for every movement, whether the haul is long or short, be modified by adopting a sliding scale, it necessarily follows that commodities can be moved from the place of production to the market for much less if they go in a single through shipment than if they go to an intermediate dealer and are then reshipped by him. The total charge for a long haul will be less than the total charge for the movement to the same destination by means of two shorter hauls. This tends

[2] See testimony of Prof. Hugo Meyer before the Interstate Commerce Committee of the United States Senate in 1905.

to centralize trade. Under the system of rate making in this country with the privileges of stop-over and reshipment at the balance of the through rate, and the basing point system, the jobber in the interior is able to compete with the shipper at the seaboard; merchants far removed from the point of production of the commodity they handle are able to sell in competition with dealers residing in the locality where the commodity is produced; and our group rates extend the markets for the products of our enterprise.

We often hear the expression that the railroads have "annihilated distance" in this country. It is the system of rate making that has annihilated distance, and it is the annihilation of distance by the system of rate making of the railroads that is responsible very largely for our tremendous industrial development. In Germany, the railroads do not have that effect because their system of rate making does not recognize the laws of trade and competition. Suppose there had been maintained in this country for the last forty years, under government regulation, a system of strictly distance tariffs, there would have been no substantial industrial development in the states between the Mississippi River and the Rocky Mountains. The reduction of rates on grain from the prairies to the East, to a point where they would stimulate production and move the product, resulted in a reduction in the value of farm lands in the New England and Middle States and an increase in the value of farm land in the West, but this has not proved to be destructive to the industrial growth of New England and the Middle States. The increase in the farm values in the West has induced immigration to these farms, and the consequence has been a wide extension of the markets for the manufacturers of the East. The policy of the rate makers has been to build up the industries on their respective lines by making rates, as far as possible, that would permit the products of those industries to be sold far and wide in competition with similar products of industries situated in remote parts of the country.

It may be said that this is no argument against government regulation. We do not make the statement primarily as an argument against government regulation. What we do say is that any effort at government regulation must recognize these principles and follow the plan which the railroads themselves have adopted, or it will do more harm than good. But it is hardly likely that the government will be able to regulate rates comprehensively, with as

much success as the railroad managers themselves. Two great forces which control the rate makers to-day are: (1) the desire to stimulate production along their respective lines, and (2) the contest of trade centers for supremacy. These are competitive forces of a powerful nature, and any governmental body which should undertake to fix all the rates for transportation in this country would probably be compelled to ignore the first, and would be likely to be accused of being influenced by political considerations, if it undertook to give any recognition to the second.

III. *Limitations by Common Law.*

We have said that there are two classes of regulations which control the rate makers of this country, the first being limitations by economic laws. Another class of limitations is made up of those imposed by common law.

It has been the rule of the common law from time immemorial that when one devotes his property to a use which is of such a nature, by reason of public aid in its investment or by reason of the monopolistic character of the service rendered, that it is said to be impressed with a public interest, he is bound to content himself with charges that are reasonable. So, if a man erected in a harbor a wharf or crane which by reason of a grant of public aid in its construction, or by reason of the fact that there was no other crane in the harbor, could be said to be impressed with a public interest, it was held that he must limit his charges to such as would constitute a reasonable reward for the service rendered. In comparatively modern times and particularly in this country in the period of the Granger cases, there was an attempt to regulate charges for public utilities by legislation and it has been held to be a rule of common law that while the charges for such public utilities must be limited to such as constitute reasonable compensation for the services rendered, at the same time they may not be reduced by legislation to a point below what will yield a fair return to the owner upon his investment. The existing national legislation upon the subject of rates has done little more than to declare the principles of the common law, which are more than two centuries old. And after all, reasonableness is really the sole test of the validity of a rate for transportation by a common carrier. This is the limitation to which we now refer,—that rates shall be reasonable.

It becomes important to inquire what are the considerations which control in a determination of the question of reasonableness. We have already noted the fact that there may be a wide range of rates for the performance of a given transportation service within which any rate charged will be held to be reasonable. The lowest will be the minimum and the highest will be the maximum. The question of what is the minimum rate which will be held to be reasonable, generally arises upon the complaint of the carrier, while the question of what is the maximum rate, usually arises on complaint of some customer of the carrier, or on complaint of some public officer, and the considerations which control in determining the two questions are as far apart as the different points of view.

First, then, in a review of legislative action, what will be held unreasonable upon complaint of the carrier? What is the minimum?

It has been held by the courts that a railroad company is entitled to charge rates which will enable it to pay its legitimate operating expenses, taxes, the cost of maintenance, and interest upon money borrowed and actually devoted to the enterprise, and some return upon the investment represented by the capital stock. Some cases hold that the carrier is not only entitled to all these things and *some* return upon the investment represented by the capital stock, but a *fair* return.

It may happen that the property devoted to the enterprise at the time of the investigation of the question of the reasonableness of the rates may be worth much more than it originally cost, or much less, and some courts hold that what the carrier is entitled to is a return upon such value at the time of the investigation, regardless of the original cost.

In the application of any of these rules difficulties are likely to be encountered, for it is uncertain what deductions are to be made from the gross earnings on account of operating expenses and maintenance, and it is also uncertain how we are to determine the actual amount of money borrowed and devoted to the enterprise and how we are to determine the amount of actual investment represented by the capital stock; and if we adopt the other rule, allowing value to determine the investment, it is not clear what method is to be employed to measure the value. When a proper method has been adopted for the determination of the extent of the investment, it should be held, upon the complaint of a carrier, that he is entitled

to a fair return upon his investment. This fixes the minimum of reasonableness.

Second, in a review of legislative action, what will be held unreasonable upon the complaint of a shipper? What is the maximum?

Upon the complaint of a shipper, the net revenue of the carrier has nothing to do with the determination of the question of reasonableness. No shipper has the right to complain of a rate or a schedule of rates simply because the carrier is able to pay large dividends. As long as the rates charged do not exceed the value of the service rendered, the shipper has no right to complain; and the value of the service rendered is determined by commercial considerations, one of which is the cost of the service. Shippers are apt to forget that there has been for a number of years in this country a general upward tendency in the wages paid to the men and in the price of almost all kinds of supplies. Higher speed is demanded. Better accommodations for passengers are being constantly provided. Expensive safety appliances have been required. All these tend to increase the value of the service, and yet there are few persons who are willing that there should be any corresponding increase in the rates. On the contrary, there is a constant tendency downward in passenger rates wherever they are subject to state regulation, and the slightest increase in the average freight rate per ton per mile in the United States taken as a whole and averaged for a year, is viewed with suspicion and furnishes a text for an outburst of passion against the railroads. Upon the complaint of a shipper it should be held that the carrier is entitled to the fair value of the service rendered. This fixes the maximum.

A correct judgment as to the value of the service rendered in any given movement of freight depends upon the commercial conditions surrounding the movement, and it often happens that a complaint that rates are unreasonable may require for its proper adjudication a careful inquiry, not only into the business of the road that makes them, but also into the business of other roads, whose rates are supposed by comparison to show the injustice of the rates complained of.

Between these two points: the rates which will yield a return upon the investment as the minimum, and the rates which will not exceed the value of the service rendered as the maximum, there may be, and often is, a wide range, within which the carrier is at

liberty to prescribe the rates under the full protection of the law. And within this range it has been judicially determined that carriers are justified in charging less for a long haul than for a shorter haul over the same line in the same direction, the shorter haul being included within the longer distance, in cases where competition controls the rate to the longer distance point; and that carriers may charge less for the inland portion of the transportation of export or import freight than is charged for a similar movement of domestic freight.

It is probably true that these practices, both of which have been sustained by the courts, constitute the real basis of a great majority of the supposed grievances of which the shippers complain, but these practices are forced upon the carriers by trade conditions, and they are practices which distinguish the railroad business of this country from the railroad business in a country where trade conditions are ignored by government regulations, and where railroad construction and development is practically at a standstill. These are the practices which annihilate distance and tend to decentralize the population. The prohibition of these practices by a statute, upon the demand of the persons living nearest the great markets that they should be given the advantage to which their geographical location is supposed to entitle them, would stop the development of the interior and cripple the railroads and would produce restrictions upon the revenue of the carriers, which in many cases would probably be held by the courts to be unreasonable; and would impose, in other cases, rates beyond what the traffic would bear.

The present adjustment of railroad rates is most complicated, but it is the result of the operation of economic laws. The railroad managers have not made rates for the transportation of freight at will. They have been forced to limit the rates to what the traffic will bear,—using that expression, not in the offensive sense, as a description of a maximum of burden to which another straw could not be added without disaster, but in the sense in which it is used among traffic managers, as representing a rate which will stimulate production and move the product and at the same time yield a fair return to the carrier upon his investment in the enterprise. Rates thus adjusted will stand the judicial test for reasonableness, and no state or federal authority should deprive the carrier of the revenue which such rates will afford.